1955

First National City Bank
Monthly Letter
Business and Economic
Conditions

New York, October, 1955

General Business Conditions

THE news of President Eisenhower's sudden illness came as a shock to the entire nation and to the world. The faith and affection which he has inspired in human hearts has made his illness a matter of concern not only to Americans but to the people of all countries. The first thought of this nation, and of the world, is for the welfare of the President himself, and anxiety for his speedy recovery.

Because of the confidence that has been placed in his leadership, the President's illness has inevitably overshadowed all other developments affecting business during the month. Literally overnight, business men and investors everywhere found themselves under the necessity of reappraising the situation and outlook in the light of new political and economic uncertainties little dreamed of only twenty-four hours earlier. In these circumstances, it is not so surprising that the stock markets — always sensitive to changing moods and sentiment — took a jolting after their long-sustained advance.

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Grounds for Encouragement

It would, of course, be idle to suppose that it is possible to foretell with any degree of assurance the long-range significance of what has transpired. Events must unfold of themselves. Meanwhile, the American people are fortunate that in this time of renewed questioning about the future they have much from which they can draw encouragement.

First are the favorable reports of the President's condition, fostering hope that he may in due course be able to resume normal duties and bring his steady hand once more to the wheel.

Second is the fact that the President in his three years of office has surrounded himself with men of ability and integrity, constituting a strong team equipped to carry out during his convalescence the well-defined policies that have been laid down. As Secretary of the Treasury George M. Humphrey pointed out:

> Our policies and programs are definite and firmly established. There is no reason to anticipate any change. We will carry on in his absence exactly as previously planned. There is no reason for others to do otherwise.

Third is the basic strength and vigor of the economy itself under the policies that have been so constructive over the past three years. Despite the rise in production and employment that has taken place so far from the low points of the past year, there is no clear evidence that the forces of growth and development have exhausted themselves. One of the indications that the situation is not ripe for a downturn is the absence of the inventory excesses that are the usual accompaniment of the last stages of a boom.

Business Judgment Not Likely To Be Hasty

In the light of these circumstances, it seems doubtful indeed that business men by and large will be precipitate in heading for the cyclone cellars. Most businesses are concerned for the short run in meeting the every-day demands of

their customers, and for the long run in maintaining their competitive positions through betterment and enlargement of their facilities for production and distribution. Evidence of the cumulative effect of business expansion appears in data published last month showing projected business expenditures for new plant and equipment in the latter half of this year to be at a new high record.

These outlays, according to a joint survey by the Department of Commerce and the Securities and Exchange Commission, are scheduled at a seasonally adjusted annual rate of $29.4 billion in the third and fourth quarters. This is 9 per cent more than business men reported they were planning to invest in this same period when surveyed six months earlier, and 2½ per cent more than was invested in the peak second half of 1953. The rebound in new capital spending from the low first quarter of this year to the last is particularly marked among railroads and durable goods manufacturers.

Among the latter, the need to keep up with customers' requirements has been an important factor in planning investment. Steel companies, in particular, have pushed output close to practical capacity without appreciably denting their backlogs of unfilled orders. In fact, customers would willingly place more orders for steel than the mills are able to accept. As a result, a new round of expansion may be forthcoming, even without the stimulus of accelerated amortization for tax purposes. Republic Steel has already announced a $130 million program to expand capacity 16 per cent by mid-1957.

Programs of modernization and expansion such as these are made on a long-range basis and not readily cancelled. At the same time, few business concerns are likely to hold back in their current buying so long as the products they have to offer are selling freely.

A Sobering Influence

Finally, it may be suggested that the problems we have been facing recently have been problems of too much prosperity rather than too little. President Eisenhower himself warned not long ago of the danger of overdoing the boom. The Federal Reserve Banks have permitted the rising demand for credit to tighten the money market generally, while the government authorities concerned with home mortgage credit have taken steps to reduce somewhat the supply and tighten the terms in this area.

To the extent that a note of caution has been injected into the markets, it serves to reinforce these monetary restraints and to bring nearer the time when such restraints can be relaxed. In the case of the stock market, the shake-out comes as a timely reminder that prices can go down as well as up.

Pressure on Lenders

Effective Friday, September 9, the Federal Reserve Bank of New York raised its discount rate to 2¼ per cent. Paralleling action by other Reserve Banks created a uniform 2¼ per cent rate among the twelve Banks as of September 13. The last time they were all together was August 3 at a 1¾ per cent level. The Cleveland Bank then raised its rate by ½ to 2¼ per cent; the others moved in two ¼ per cent steps, spaced-out over a period of five weeks.

These final discount rate actions had limited market impact inasmuch as, at least toward the close of August, the general adoption of a 2¼ per cent rate had become a foregone conclusion. As a matter of fact, bond prices steadied early in August and in September tended to recover some lost ground. The forty-year 3s issued by the Treasury earlier this year, which touched 98¼ on August 4, regained a par level. A number of large corporate bond offerings were made, the most notable being more than $600 million convertible debentures offered to shareholders of the American Telephone and Telegraph Company. Short-term open market money rates steadied in early September when the return offered on prime 90-day bankers acceptances was advanced ¼ per cent to 2⅛ per cent and prime 4-6 months commercial paper was lifted another ⅛ per cent to offer the buyer 2½ per cent. Weekly issues of three-months U.S. Treasury bills have been sold at rates ranging around 2 or 2⅛ per cent since the end of August.

Bank Borrowings Increase

Federal Reserve policy during September was directed at keeping lenders under controlled pressure. To this end the authorities sold $197 million Treasury bills in the open market during the two weeks ended September 21 and bought $138 million in the following week. The member banks of the Federal Reserve System raised their borrowings from an average of about $760 million in August to approximately $840 million in September, the highest monthly average since May of 1953.

Higher levels of bank borrowings from the Federal Reserve are in prospect for the final quarter of the year as the banks fill their needs for funds to meet seasonal pressures generated out of crop movements, autumn trade expansion, and increase of currency circulation up to

the Christmas peak. On top of these requirements, the Treasury is coming to market in this period to cover its usual fourth quarter deficit. It remains to be seen to what extent the Federal Reserve will buy government securities and relieve bank needs to borrow.

In the last four years the Reserve Banks have bought an average of nearly $800 million government securities in the four months, September through December. Member bank borrowings have increased an average of about $200 million. The most active use of the discount facility was made in 1952 when the policy pursued was also one of restraint. Borrowings then rose to a daily average of $1.6 billion in December.

The Rate Structure

While well short of the December 1952 figure, which stands as the postwar peak, borrowings recently have been continuous and heavy enough to make the discount rate the effective point of reference for the entire money rate structure.

Other rates are holding an orderly relationship to the discount rate. Treasury bill yields, while subject to fairly pronounced week-to-week fluctuations, recently have been averaging ⅛ to ¼ per cent below the discount rate. Prime 90-day bankers acceptances are ⅛ per cent below the discount rate. Prime 4-6 months commercial paper is quoted ¼ per cent above the discount rate and ⅜ per cent or more above Treasury bill yields. The prime loan rate, the minimum rate charged by leading banks to customers of the highest credit rating, stands 1 per cent above the discount rate and ¾ per cent above the prime commercial paper rate. Yields on U.S. Treasury bonds and notes are arrayed between the discount and the prime loan rates. As the table shows, the relationship among money rates corresponds to that held in February of 1953 after an increase to a 2 per cent discount rate January 16. Bank borrowings from the Federal Reserve at that time were averaging $1.3 billion.

Short-Term Money Rate Structure

	Feb. 1953	Sept. 1955
Prime Commercial Loan Rate	3.00%	3.25%
Prime 4-6 months Commercial Paper	2.25	2.50
Discount Rate	2.00	2.25
90-day Bankers Acceptances	1.88	2.13
Treas. Bills, avg. yield on new issues	2.02	2.09

The Prime Loan Rate

Some speculation was current in September that the further increase in discount rate might precipitate another move in the prime loan rate, raised from 3 to 3¼ per cent on August 4. This rate, while not tied to the Federal Reserve discount rate in any exact way, over the past four years has generally maintained a margin of 1 to 1¼ per cent over the discount rate. In 1954 two discount rate cuts to 1½ per cent produced only one prime rate cut to 3 per cent, opening a margin of 1½ per cent. Three ¼ per cent discount rate advances this year, with only one ¼ per cent rise in prime rate, have reduced the margin to 1 per cent.

The credit standards of eligibility for the prime rate have tightened this year as the margin has shrunk, just as they loosened when the margin spread to 1½ per cent last year. Declines in the prime rate generally come when competition for loans has widened eligibility for the rate, and advances occur when banks have such strong loan demands that they do not mind deflecting some loans to other institutions, or to the bond market, by asking higher rates.

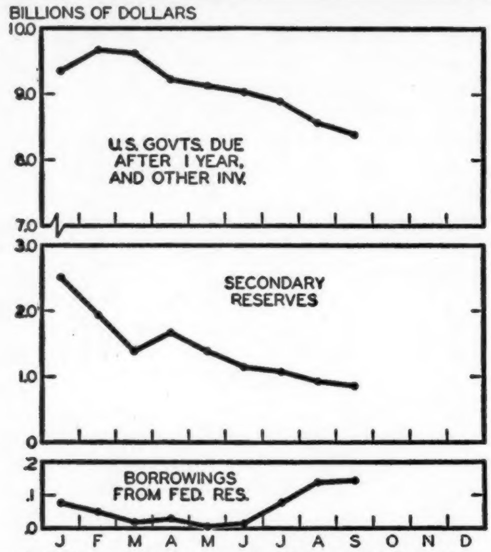
Speculation over the possibility of another advance in the prime loan rate last month seemed to be based chiefly on the sizable losses banks experience when they dispose of bond investments in order to meet loan demands. The New York City banks, which make the bulk of the loans at the prime rate, have been faced this year with the combination of strong loan demands and a weakening trend in deposits, the latter a result of higher open market money rates which tempt depositors to invest inactive balances.

Pressures on New York Banks

As a result of these pressures the secondary reserves of the New York banks have been reduced from $2.5 billion in January to $0.9 billion in September. Secondary reserves include earning assets which are held for the purpose of meeting increases in loan demands or decreases in deposits, and are quickly convertible into cash without loss or injury to customer relationships: Treasury bills, other U.S. obligations due within one year, and call loans to government security dealers. Investments due beyond one year, mainly U.S., State, and municipal bonds, have been cut $1.0 billion this year, but losses involved in liquidating investments widened with the bond price declines of February and July. In order to avoid or limit losses on bond sales the banks have been borrowing more from the Federal Reserve Bank.

The shrinkage of New York banks' investments and secondary reserves, and the increase in their borrowings, are brought out in the chart on the next page.

Bonds have not dropped as low or as rapidly as they did in the spring of 1953 when the Victory Loan 2½s due December 15, 1972 (now 95½) broke 90. Yields on longer U.S. bonds then reached the 3¼ per cent prime loan rate; today the yields on U.S. bonds do not exceed 3 per



Portfolio Investments, Secondary Reserves and Borrowings New York City Banks Monthly Averages for 1955

cent. Banks, however, have more red ink out of a more moderate price drop because they lengthened their portfolios so substantially during 1954. For example, sale today of Treasury bonds acquired on initial issuance during the second half of 1954 would involve losses wiping out all interest income received on such bonds. This illustrates, incidentally, how the Treasury policy of stretching out public debt maturities has made the banks more sensitive to changes in Federal Reserve policy which result in bond price fluctuations.

Banks generally are not forced to take losses on bonds. They may tighten up lending standards or quote rates unacceptable to the borrower. Within limits of law and what they can afford, they may offer higher rates for time and savings deposits. They may borrow from the Federal Reserve, at least up to the point where the Federal Reserve authorities clamp down on the use of the discount facility. At that point the choice narrows to taking losses on bonds, slowing up on lending, or both.

Robert B. Blyth, Assistant to the Secretary of the Treasury, speaking before the National Association of Supervisors of State Banks on September 23, pointed out the wider significance of fluctuations in bond prices:

> The appraisal of a bond account does give a temperature reading of the condition of the economy. The loss figure that exists today in the appraisal of many bond accounts simply indicates that we have a strong, vigorous economy with heavy demands for credit. We have a situation where there is a danger that too many activities will be undertaken with borrowed money, resulting in an expansion of money supply beyond our productive capacity.
>
> Under such conditions, it is appropriate that bankers use common sense and prudence in the extension of credit. If the bankers of the country do exercise care in the extension of credit as a result of the decline in the bond market, the free markets will have served their function in a natural way.

Effect on Savings Institutions

The commercial banks, to be sure, are not alone in feeling the change of climate in the money market. A higher cost of money cuts into profit margins of instalment credit houses and dictates closer screening of credits to control loss ratios. Lower bond prices discourage insurance companies and savings banks from selling investments to increase their mortgage lending capacities, and the greater reluctance of commercial banks to undertake new mortgage warehousing commitments works to the same end. Savings and loan associations, relying upon advances from the Federal Home Loan Banks to expand home mortgage lending, have been warned by the Federal Home Loan Bank Board in recent months against over-borrowing to expand housing credits. Concerned over "the tremendous increase in lending . . . without a corresponding increase in net savings", Walter W. McAllister, Chairman of the Board, advised member institutions on September 13 to "meet loan demands out of saving and loan repayments." Since August 11, nine of the Federal Home Loan Banks have increased the rate charged on member institutions' borrowings. Depending on the district, rates charged now range from 2½ to 4 per cent.

One sequel of the tightened money market is a renewal of efforts of savings institutions to stimulate the savings flow. This is timely because some of the 1955 spending surge has been accommodated at the expense of reduced current saving. Unless the savings stream holds up, the volume of money available to finance car and home purchases — and the building of roads, schools, factories and stores — is constricted. We overstrain our supply of savings only at the cost of inflation.

Speaking at the annual convention of the American Bankers Association in Chicago on September 27, W. Randolph Burgess, Undersecretary of the Treasury, set out the broader problem:

> We must see that prosperity does not blind us and turn our heads, does not lead us to over-commitments, or to excesses which will tip us over into a recession . . .
>
> At such a time, your Government has these responsibilities: to balance the budget, so that a deficit does not

contribute to inflation; to keep a rein on Government credit; to exercise wisely its legal powers over private credit.

The $64,000 Question

The television program, "The $64,000 Question", the most popular on the screen today, has attracted audiences estimated as large as 55,000,000. It has also brought to the notice of listeners, and most emphatically to the attention of participants, the heavy cut Uncle Sam demands from the winnings of successful people.

Since the program was launched, four months ago, four persons have successfully doubled their money up to the $32,000 mark, answering questions on such varied topics as the Bible, opera, food, and baseball. Reaching $32,000, three of the contestants dropped out. It took the raw courage of a United States marine, Captain Richard McCutchen, to attempt the $64,000 question. Excusing his imprudence, he explained: "I belong to a very proud organization."

The participants have had a lot of good, free advice. Hundreds of listeners from all over the country have written or telegraphed warnings that $64,000 is not, as it might seem to be, double $32,000 but only about half again as much. The rules of the income tax supersede the laws of arithmetic. To a single person with a $4,000 income from other sources, a winning of $32,000 gets assessed an additional federal tax of $15,400 leaving $16,600 as the actual prize. An extra $32,000 winning would get assessed a tax of $23,292, increasing the prize by no more than $8,708. Thus he is risking an assured $16,600 for a chance to win an additional $8,708.

The tax laws treat people who are married or have dependents less harshly. But our single person would need a nominal prize of $107,600 to have and keep $32,000, and a nominal prize running to $448,711 to have and keep $64,000.

Prizes Before Tax Required to Double Prizes After Tax

(For single person with regular income of $4000)

Prize	Share of Tax Collector	Share of Contestant
$ 1,253.26	$ 253.26	$ 1,000.00
2,558.75	558.75	2,000.00
5,260.20	1,260.20	4,000.00
11,675.47	3,675.47	8,000.00
30,285.71	14,285.71	16,000.00
107,600.00	75,600.00	32,000.00
448,711.11	384,711.11	64,000.00

The program has provided a vivid illustration of the way confiscatory personal income tax rates stack the cards against risk-taking ventures. Tens of millions of listeners have seen people, because of tax considerations, decide against taking the chance of turning $32,000 into $64,000. They rebel, not unnaturally, when the Internal Revenue collector claims the major slice of the pie. This strikes people instinctively as unjust.

Although less well advertised, tax rules dictate answers of "no" every day of the week to businessmen, investors, and professional men of every description. The injury is not only to the opportunities of people but also to the tax collections. Risk-taking enterprise affords the richest source of government revenues.

In the consideration of changes in the personal income tax next year, Congress will do well to ponder the desirability of finding a schedule of rates that encourages people to go ahead. For people who feel the urge and have the talent to go ahead the real $64,000 question is what the Congress will determine to do.

The New Market for Automobiles

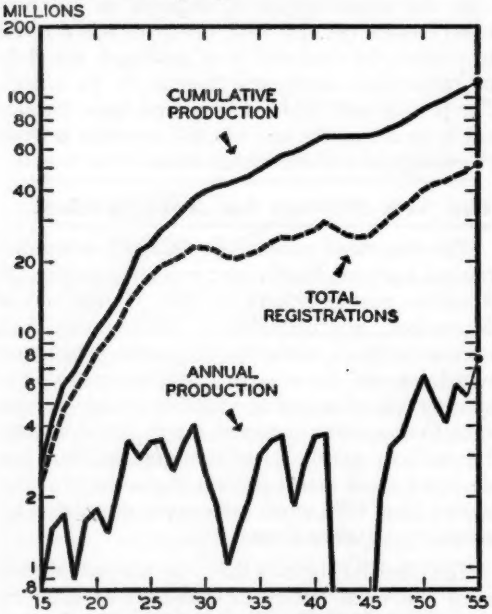
The American automobile industry is headed toward a record-shattering production volume of 8 million passenger cars in 1955. By the end of September, approximately 6 million cars had been assembled, while fourth quarter production schedules call for nearly 2 million more. Excluding cars exported or added to dealers' stocks, sales to domestic consumers are expected to total 7.4 million, nearly 2 million greater than last year and more than 1 million above the previous record year 1950 when sales were stimulated by scare-buying after Korea.

The demand for cars this year has outstripped even the most optimistic forecasts of industry leaders. Last November Harlow H. Curtice, president of General Motors, predicted that 1955 domestic production and sales of passenger cars would total 5.8 million. On March 3, '55, he revised the estimate upward to 6.6 million — still far short of actual performance. While the public's enthusiastic response to the '55 models took the experts by surprise, the factories and dealers quickly made the most of it, and have rolled up new production and sales marks nearly every month.

With 1956 models beginning to appear, the question naturally arises whether or not the spectacular 1955 record can soon be duplicated. The old rules for measuring the basic demand for cars no longer seem adequate to explain the sales performance witnessed this year. Have we shifted to an entirely new type of automobile market? Could it be that we are just catching up with a long-term trend in car ownership? Or will it turn out that we were merely borrowing sales from the future? In short, where does the demand for automobiles come from?

Sources of Demand

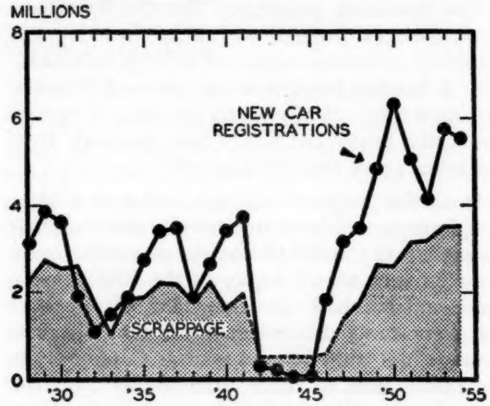
The total number of cars registered has grown from next to nothing at the turn of the century (only 8,000 cars were registered in 1900) to more than 50 milllion in 1955. The vigorous growth of automobile ownership during the first three decades of this century was interrupted, as shown by the following chart, first by the depression of the '30s and then by World War II. In the last ten years, the curve of car population has again risen rapidly.



Growth of the Passenger Automobile Market, 1915-55
(Production figures exclude cars for export; ratio scale to show proportionate changes.)

The growth in the number of cars on the road has reflected many things — improvements in the vehicles themselves and in methods of production, increased population, higher incomes, availability of credit, and the shift to suburban living. But "new demand" — people buying their first car or their first "second car" — is only part of the over-all sales picture. A substantial part of sales represents replacement. As the above chart shows, less than half of the 109 million cars produced for the domestic market through the end of 1954 were still on the road at that time. The rest had been scrapped, wrecked, or otherwise withdrawn from use. Every year, more millions of cars head for the automobile graveyards, and in most cases other cars are bought to replace them.

In terms of the over-all car market, replacement demand for new and used cars is equivalent to scrappage (which includes wrecks and other withdrawals). Net new demand is equivalent to the increase in cars on the road, and is measured by the difference between the number of new cars sold and the number of old cars scrapped. The course of these two series is shown in the chart below.



New Passenger Car Sales and Scrappage, 1928-54
Source: Registrations, R. L. Polk & Co.; Scrappage, Automobile Manufacturers Association (1942-46 level represents average for the period).

It is clear from the chart, however, that the number of cars scrapped has only an indirect relation to the number of new cars sold. The volume of scrappage does not determine new car sales; in fact the opposite is sometimes the case.

The market for motor cars differs from that for most consumer durable goods because of the existence of a large used car market. The purchaser of a stove or refrigerator is likely to buy it new, use it for ten years or more, and then buy another one new. In the automobile market, a person's first car, or first additional car, is more likely to be a used one. The person who buys a new car is seldom the same person who scraps it.

Ordinarily a car changes ownership several times in the course of its life. A 1953 survey showed that three fourths of car owners traded in their cars less than 5 years after they bought them. Only 10 per cent kept their cars 10 years or more.

Thus the people who decide to buy a car for the first time or to scrap an old one are not ordinarily the same set of people who decide to buy new cars, although they may be influenced by the same set of economic circumstances.

A Self-Sustaining New Car Market

The market for new cars is, of course, the most important part of the automobile market from the standpoint of industrial production and economic activity generally. In the period of sustained high income and employment which has

prevailed almost without interruption since World War II, there appears to be building up what might be called a self-sustaining new car market. Once a family reaches the economic level at which it can purchase a new car, it tends to buy its subsequent cars new rather than used. A recent survey by U.S. News and World Report showed that four out of five of the cars traded in by persons buying new cars in 1954 had also been bought new. Two thirds of these new car buyers had owned their previous car only 3 years, and 92 per cent of the cars traded in had been owned 5 years or less. An equally large proportion planned to trade in their 1954 car within 5 years.

This idea of a regular turnover of new cars by a steadily growing sector of the population was expressed at a National Industrial Conference Board economic forum by George P. Hitchings, manager of the Economic Analysis Department of the Ford Motor Company, in November 1954:

> The fact that we have sold in the six-year period, 1949 through 1954, an average of five and a quarter million cars a year to domestic customers sets in motion automatically the forces to produce in the next 6-year period a total that large or larger, because most of the new car buyers come from the people who own cars six years of age and under.
>
> The problem in any one year, of course, is what proportion of people owning cars in this age group will trade in for new cars.

When and whether these car owners decide to trade in for a still newer car (and used car owners decide to upgrade to a new car) depends upon many factors, including general economic conditions, automobile style changes, income levels, and shifts in family living patterns. One very important element in these decisions is the trade-in allowance an owner can obtain for his old car. Here the growth of demand and the rate of scrappage exert their indirect effect on the new car market through their influence on used car prices and hence on trade-in allowances.

Approximately nine out of ten new car sales add an additional car to the used car market through trade-ins, direct sales, or otherwise. The prices at which the used car market absorbs these additional cars reflect, on the one hand, the increase in demand from people purchasing cars for the first time and, on the other, the reduction in supply through scrappage. At the same time, as in most free markets, the price level has an important effect on both new demand and scrappage.

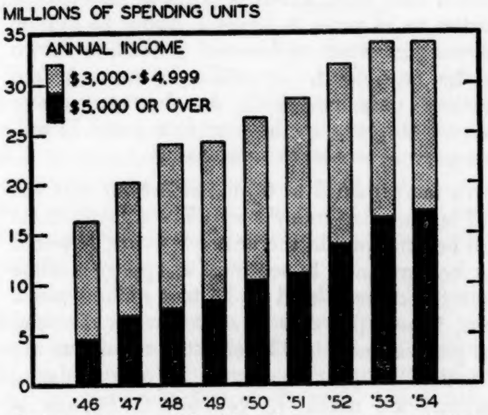
New demand may be stimulated by attractive prices and model changes, as in the current year, or by other factors, including such unpredictable events as the scare-buying following the start of the Korean War. In the long run, however, it arises from household formation, the growth in the population of driving age, and trends in the level and distribution of income. As outlined by Mr. Hitchings before the Joint Congressional Committee on the Economic Report in February 1954:

> Growth in total car ownership occurs because of (1) increase in the number of households and (2) increase in ownership per household. Household growth currently amounts to about 2 per cent a year. Car registrations per household have moved up from the reduced level of 66 per 100 households in mid-1946 to 90 in mid-1953. This does not mean, of course, that 90 per cent of the households own a car. It merely represents the number of cars divided by the number of households. Some households own more than one car, and some cars are owned by businesses or were in used-car inventories of car dealers. There will be further growth in ownership per household, but it will be closer to the long-run average annual rate since 1929 of 0.8 per 100 households than the 3.4 rate of the postwar period.

On this basis, new demand would normally average about 3 per cent per year, or in the neighborhood of 1.4 million cars. An important part of this demand is the growth of 2-car families, now estimated to be over 10 per cent of all families.

Growing Incomes and Markets

A major element in the whole automobile market has been the steady increase in the number of families in the middle and upper income brackets. The next chart shows how these groups have expanded in the past decade.



Estimated Number of Spending Units with Income of $3000 or More — 1946-54

Since 1946 the number of spending units with incomes over $3,000 a year has doubled and the number receiving $5,000 or more has quadrupled. At the same time, the number receiving less than $3,000 a year has dropped 10 million, or one third. Part of the improvement is due to postwar wage and price inflation, but even in the period of relatively stable prices since 1951,

the gains have been impressive. Studies also indicate that a steady, year-after-year advance in a family's income can be as much of a factor in deciding on a major purchase such as a car as is the actual level of income.

The larger incomes of today's middle-income families provide not only cash for car purchases, but also the ability to carry a sizable load of instalment debt. The rise this year in automobile instalment paper outstanding has been spectacular, totaling $2.6 billion or about one fourth in the first seven months alone. Without this credit expansion the 1955 automobile sales records would not have been possible. At the same time it is reassuring to note that the heaviest users of instalment credit have been concentrated in the very groups in which the growth in incomes has been greatest.

To Scrap or Not to Scrap?

The decision whether or not to scrap a car usually rests with the dealer in used cars, who weighs the price he can get for it against the cost of putting it in salable condition. With repair costs rising and used car prices declining, the number of cars scrapped in recent years has mounted rapidly, as shown in an earlier chart.

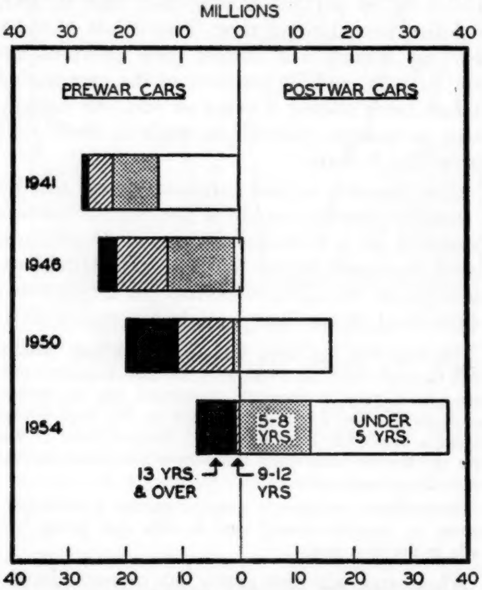
During World War II and the early postwar period, relatively few cars were scrapped because supplies were limited and prices high. The average time a car was driven before it was junked rose from about 8 years in the middle thirties to 14 years in 1949-53. About 25 million prewar cars were on the road in 1946, as shown in the next chart. By 1950 the number had declined only one fifth. As shortages disappeared, however, in the next four years 12 million prewar cars were scrapped.

No more than 5 or 6 million prewar cars are still on the road today and, while most of them will be scrapped in the next few years, it would not be surprising to see total scrappage decline from the current level of 3½ to 4 million cars a year. Ninety per cent of cars now on the road are postwar models. The oldest postwar cars are less than 10 years old and the overwhelming majority are under 7, well below the age at which scrappage becomes substantial.

However, the average scrappage age may tend to decline toward the 8-year prewar average, reflecting lower used car prices and possibly a higher rate of obsolescence as well. In time, the increasing complexity of repairing modern cars and their power equipment may hasten the age at which scrapping becomes more economical than repair.

Age Distribution of Passenger Cars in Use
(As of July 1)

Age	—Millions of passenger cars— 1941	1946	1950	1954
Under 5 years	14.0	1.4	16.0	23.7
5 - 8 years	8.0	11.5	1.0	12.4
9 - 12 years	4.4	9.0	10.7	0.6
13 years and over	1.1	3.1	8.1	7.6
Total	27.5	25.0	35.8	44.3
Total postwar	0	0.5	16.0	36.1
Total prewar	27.5	24.5	19.8	8.2



The Changing Car Market

An outstanding feature of the automobile market during the last few years has been the intensive selling efforts by dealers, spurred by the hot competitive race between leading manufacturers. In the effort to build sales volume, many dealers cut prices — and their profit margins — either through outright discounts or by over-generous allowances for trade-ins. This opportunity to make a "deal", plus heavy promotional efforts by dealers and manufacturers, stimulated consumer interest and contributed to the 1955 sales record.

The attractive prices, together with easier credit terms on new cars than on used ones, are credited with switching families who would ordinarily have bought late model used cars into the new car market. Nevertheless, sales of used cars in 1955 have been high, as lower prices and increased supplies of good postwar models brought out increased demand.

The merchandising techniques of the automobile industry have elevated cars to a unique place in the consumer budget. Nearly one out of four American families bought a new or used

car last year — more than purchased other major types of consumer durable goods, even at a fraction of the price. More new cars were sold last year than topcoats, and families spent more money on cars and their operation than they did on all types of clothing.

Considering that 1955 may go down as the most prosperous year to date in the nation's history, it is not surprising that new car sales are higher than usual. But sales running a million or two beyond normal expectation are phenomenal. As noted earlier, in a year of high income and employment the auto industry might reasonably expect to sell in the neighborhood of five million new cars just from turnover among owners of cars 1 to 6 years old. Another half million or so new car purchases might be expected from families without a previous car. Upgrading of demand among former buyers of used cars also is a source of additional new car sales. A normal new car market in prosperous years of as many as six million cars does not appear unduly optimistic.

No details are available yet as to what type of buyers are absorbing the 7.4 million new cars expected to be retailed in 1955, or as to what sort of cars they are trading in. A guess would be that the marked change in styling and attractive prices induced many car owners to trade in their cars sooner than usual and attracted a greater proportion of new buyers. These factors, plus the favorable credit situation and high employment and rising incomes, undoubtedly accelerated the upgrading of purchases by former used car buyers. Two-car ownership is growing, and constitutes an important potential source of new demand.

The chances of maintaining 1955's accelerated pace of new car buying are even more difficult to assess. The great bulk of customers who are buying new cars in 1955 will not be back until 1957 or 1958. That there are still, however, many potential customers who have not already bought in 1955 seems indicated by the continuing high rate of retail sales.

The new type of car market which seems to be developing may have unsuspected potentialities for growth. But this remains to be demonstrated. In the meantime, the car manufacturers will be under strong competitive pressure to continue maximum production schedules consistent with current public demands, and to assure through additional capital investments the existence of adequate capacity to maintain — and where possible improve — their respective competitive positions in the future.

Benelux: Experiment in European Integration

Since the war there has been much talk of the need for European economic integration. It has been urged that, if the countries of Europe are to realize the full benefits of efficient mass production and consumption, trade barriers must be reduced and the conditions of a common market more closely approached.

Despite many obstacles, progress has been achieved along three main lines: first, the reduction of intra-European trade barriers accomplished through the machinery of the Organization for European Economic Cooperation (OEEC); second, the European Coal and Steel Community (Schuman Plan); third, the economic integration of the Netherlands and the Belgium-Luxembourg Economic Union into Benelux.

The progress made by Benelux, though perhaps least well known, is impressive. Some 90 per cent of the trade among these countries has been freed from quota restrictions. Tariffs are almost nil. Only agricultural products are still subject to import restrictions and price controls. The three countries have adopted common lists of goods which may be imported freely from Western Europe and from the dollar area. Economic treaties are now negotiated by Benelux as a unit rather than by the countries separately. Capital movements within the area have, for the most part, been freed from restrictions.

Differing Economic Policies

All this has been achieved despite difficulties far greater than originally anticipated. When a postwar customs union was agreed upon in London in September 1944, the three governments expected that their countries would end the war in roughly equal circumstances and that the road to cooperation would be relatively smooth. But events proved otherwise.

Belgium, the first of the three to be liberated by the Allied advance, emerged from the war with much less damage than did the Netherlands. The Belgian ports and communications system were rapidly rebuilt with Allied help. The natural resources of the Congo supplied Belgium with many needed raw materials, and Congo exports strengthened the home country's foreign exchange position.

With production high and reconstruction needs limited, Belgium was soon able to abolish price controls and rationing in favor of high level consumption. Inflation was held in check by drastic monetary reform. Although prices and

wages rose somewhat, Belgium's principal exports, notably iron and steel, were in such strong world demand that the higher prices had no serious effect on sales. Before long the Belgian franc became one of the hardest currencies in Western Europe.

The Netherlands, on the other hand, lost in the war a third of the national wealth. The transportation system was crippled; the merchant fleet, an important prewar earner of foreign exchange, almost wholly destroyed; and the country's foreign investments heavily depreciated. From 1945 to '49 the government finances were burdened by the intermittent struggle over the colonial possessions in the East Indies.

Because of the vast reconstruction requirements, Dutch economic policies diverged sharply from those pursued in Belgium. Instead of flexible monetary and fiscal measures, the Dutch adopted "cheap money" to promote investment in conjunction with rationing to hold down consumption. Though wage and price controls suppressed the outward signs of inflation, nevertheless, with money incomes far exceeding goods, underlying inflationary pressures continued to be a source of difficulty.

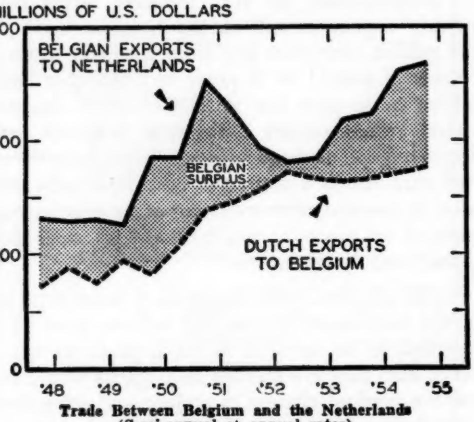
First Steps Towards Union

After the war the aim of a customs union was expanded to that of full economic union. But the inflationary pressures and direct controls in Holland, together with other policy differences, proved to be insuperable obstacles. It was apparent that Dutch consumers, holding considerable money and starved for goods, would buy heavily in the Belgian market once controls were lifted, leaving the Netherlands with an unmanageable trade deficit.

In January 1948 the countries took the step of establishing uniform tariffs on goods from the outside, but the far more important step of breaking down the trade barriers between them, originally scheduled to follow soon after, was postponed.

Matters rested there until September '49, when the general European currency devaluations afforded a new opportunity for Benelux. The devaluation of the guilder by 30 per cent and that of the Belgian franc by only 12 per cent brought the purchasing powers of the two currencies more nearly in line and made integration more feasible. In October '49 a "Pre-Union Agreement" was put into effect, involving the gradual removal of trade restrictions and attempts to reconcile the tax, price, and wage policies of the Benelux countries in preparation for full economic union.

Still, results were discouraging. Despite the currency adjustments and only partial relaxation of trade controls, Dutch purchases in Belgium expanded rapidly. As shown in the chart, the Belgian trade surplus with the Netherlands doubled from $90 million in 1949 to $180 million in '50. With the help of credits from Belgium and later from the European Payments Union, the Netherlands managed to avoid a retreat from Pre-Union. But plans for full economic union, originally scheduled for July '50, had to be shelved.



Trade Between Belgium and the Netherlands (Semi-annual at annual rates)

Then came the Korean war, completely changing the picture. The Dutch Government, faced with the sharp upsurge in prices, scrapped its cheap money policy and many of the direct controls in favor of orthodox monetary and fiscal measures and a return to free markets. The central bank discount rate was raised and the budget balanced.

These classic deflationary measures produced striking results. Imports declined, exports rose, and the Dutch balance of payments with Belgium moved from deficit to surplus. From one of the weakest currencies in Europe the Dutch guilder changed to one of the strongest, eliminating what up to that time had been the main stumbling block in the way of closer cooperation.

Benelux Crisis of 1953

Once again, however, new difficulties emerged as the tables turned. While the Dutch position strengthened, that of Belgium weakened. Due to the low postwar rate of investment and consequent lag in modernization and expansion, many sectors of Belgian industry suffered from high wages and costs. Hence, as the Korean boom receded, more and more Dutch goods competed successfully in the Belgian market. Exports declined and unemployment increased.

The Belgians urged that Dutch wage and rent controls be relaxed to allow prices to rise to a parity with those in Belgium. While this proposal was rejected as inimical to Dutch export trade generally, some Dutch industries voluntarily agreed to restrict their exports to Belgium. Finally, when Belgian unemployment continued serious, it was agreed in July '53 that Belgian industries seriously affected by Dutch imports might, under certain conditions, be protected by quotas, compensatory taxes or minimum prices.

In the following year matters improved with the broad upsurge in the European economy. Belgium's industrial production resumed its rise and unemployment declined. Since also by this time the Dutch Government was beginning to allow some wage increases, wage and price differentials between the two countries tended to narrow, thus encouraging Dutch purchases from Belgium and correcting some of the imbalance that had developed.

Freeing of Capital Movements

As both countries gained strength, it became possible in July '54 to take perhaps the most difficult step toward integration: the freeing of capital movements within the area. With the long-term interest rate in Belgium roughly one per cent higher than in the Netherlands, attractive investment opportunities were opened to the Dutch. Several Belgian loans, both public and private, have been floated successfully on the Amsterdam market. Since in Belgium the amount of capital available to private industry has generally been limited by Government borrowing, the inflow of Dutch capital may now release more funds to finance the expansion and modernization of Belgian industry.

At the same time, trade between the Netherlands and Belgium-Luxembourg has risen to a new high. The Netherlands in the first half of this year took 20 per cent of Belgium's exports as compared with 12 per cent before the war; similarly the Belgian share in Dutch exports has risen from 10 to 14 per cent. Taken as a unit, Benelux now ranks sixth in world exports, close behind Canada and France. Both the guilder and the Belgian franc are firm and the monetary reserves are at high levels. These countries are among the leaders in the movement toward currency convertibility and, acting together, have liberalized dollar imports to a greater extent than any other European country except Switzerland.

Encouraged by these developments, the governments of the three countries last spring took steps to prepare a draft for final union, which may be realized within a year.

The Future

Despite the progress made toward Benelux integration, much remains to be done. First, wages and costs are still out of line. Although the gap has narrowed in the last two years. Wage costs, including social benefits in Belgium are estimated to be still 20 to 25 per cent higher than in the Netherlands — a discrepancy that would probably cause difficulty in the event of any decline in over-all demand.

A second major problem is agriculture, where integration has made little progress and where trade is still subject to strict regulation and price control. The Netherlands is a farm exporter on balance, with prices considerably lower than in Belgium. Consequently, Belgian farmers fear having their domestic market flooded with Dutch farm produce. To prevent this, it was agreed in 1947 to exempt agriculture from the Benelux agreements, and most of the restrictions still stand. This spring, however, an official report showed that the price differentials were due less to differences in basic production costs than to Dutch advantages in marketing facilities, taxes, and subsidies. A program has been mapped out to lessen these differences, calling for abolition of all restrictions by 1962.

Progress toward integration would of course be impeded in the event of a general economic downturn, intensifying competition and sectional interests. But, considering the determination with which the Benelux ideal has been pursued up to now, it seems almost certain that progress will continue. Although several Belgian industrial groups protested vigorously against integration as recently as two years ago, opposition has now greatly diminished.

The achievements of Benelux have a significance extending beyond the three countries themselves. The whole of Europe has watched this experiment as a test case. A Benelux failure would have been disheartening indeed to further efforts to create a common European market.

Benelux, furthermore, has avoided one of the political stumbling blocks in the way of greater European cooperation. Europeans have generally associated integration with a supranational authority most of them do not want. Benelux has achieved results without the creation of any such body, each step forward having been hammered out at the bargaining table by direct negotiations. Success has depended not on new forms of organization but on patience, skill, and mutual understanding.

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